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General Business Conditions

THE problems of reconverting industry from war to peacetime work are occupying a steadily growing place in business discussions, and in the planning done by the Washington agencies. To be sure, reconversion in any general sense is not yet possible, and shifts back to civilian production will be limited and piecemeal for some time yet. The error of expecting too much too soon in the way of curtailment of war output is illustrated by the new heavy artillery and shell program, which has brought the machine tool companies sizeable new orders and is a factor in tightening the steel and copper markets again. This is an offset to contract cancellations elsewhere.

Nevertheless, cutbacks in war production are extensive and needs for certain civilian goods are pressing. Reconversion problems arise for both reasons. Moreover, stocks of munitions and war supplies are huge and still increasing, which will lead to further cutbacks. Opinion is growing that once the invasion armies are established in Western Europe and making good progress, munitions production will be reduced considerably, and that at the end of the European war contract terminations will come in a flood.

Cutbacks and Surpluses

One of the significant developments of the past month is the cutback ordered in production of Navy fighter planes, for the reason that losses of these planes have been one-third less than the estimates upon which the schedules were based. Also, it has been disclosed that requirements for new Army high-altitude fighters are now placed at lower figures than originally projected, and that cutbacks in some other types of planes are being ordered. This will mean that more effort can be put on the B-29 bombers and other desired models; but it evidently also means that the airplane program is about at its peak and due to level off. Considering that airplanes are the largest single item in the war production program, the fact that the goals are no longer being raised is important in the general situation.

Mr. Nelson, chairman of the War Production Board, has summed up the industrial materials situation by saying that whereas there were thousands of shortages a year ago, today they can be counted on the fingers of two hands. Two more aluminum production lines have been shut down during May, and other shut downs will follow. W.P.B. has authorized the manufacture of civilian goods, under approved programs, by plants even in areas designated as areas of labor stringency, provided not over 100 workers are employed. (On the West Coast the limit is 50.) Quotas have now been allocated for nearly half the 2,000,000 electric irons to be made, and for commercial laundry equipment and household electric ranges. Quotas for automobile maintenance equipment have been liberalized. Production of farm equipment is on the increase, with every prospect that the manufacturers will be almost fully reconverted, by the end of the year, to making their normal products. The Army has returned 28 transport planes to the airlines.

In foods the accumulation of surplus supplies, exceeding the storage space available, is producing some extraordinary developments. The capacity of slaughtering plants is so taxed that embargoes on shipments of animals to packers are more nearly the rule than the exception, and the amount of lard destined for soap making rather than for food this year is now estimated at 250,000 tons. Overproduction of poultry is so great that the War Food Administration has recommended the voluntary closing of hatcheries during the Summer months and the culling of poultry flocks by 27 per cent. At the same time it has been disclosed that eggs are being made into animal foods, as a method of using the egg surplus. Increased production of ice cream is permitted in New York, to absorb surplus whole milk that would otherwise be dumped. The cut in allotments of sugar for industrial users for the second quarter was lately rescinded, retroactive to April 1.

"Be Ready to Turn Around"

All these developments give point to a remark by Mr. Nelson in an address in New York May 29, that "we have reached the point where we have to set full speed ahead on military production, and at the same time be ready to turn around quickly and move in the other direction."

Sooner or later the all-out production of the industries will turn any remaining shortages of war products into abundance. Even then there will still be new or improved weapons and equipment to make, replacements to provide, and unforeseen requirements to meet, as the military situation changes. It would be indefensible to run the risk of not having enough of everything, or to permit reconversion prematurely. But it would be equally indefensible not to prepare for the moves to be made when blanket cancellations become possible, to facilitate the transition to peacetime work with a minimum of industrial depression and unemployment.

Encouraging progress has been made along these lines, particularly in the legislation governing contract termination. On May 4 the Senate passed unanimously the termination bill (S.1718) sponsored by Senators George and Murray and supported by Messrs. Baruch and Hancock, which has had general indorsement. This unanimous vote and the prestige of the men named should influence the House also to favorable and prompt action.

The War Production Board has organized a new committee and staff to make recommendations as to placement of cancellations and use of facilities released from war work. It is endeavoring to arrange with the automobile industry some practical agreement on the distribution of cutbacks in war contracts and on resumption of passenger car production, when this becomes feasible, that will be as equitable as possible to producers; and a program is promised by July. In magnitude and significance this is the most important reconversion problem to be tackled. The Surplus War Property Administrator, Mr. Clayton, is making good progress in drawing up the program and organizing for the disposal of surplus goods.

Reducing the "Bloat"

As the Army and Navy and W.P.B. find it necessary to decide where and when to cut back production of certain war goods, it becomes apparent that one of the recommendations of the Baruch-Hancock report was very pertinent. The report recommended that necessary decisions be made promptly; otherwise later decisions will be made more difficult. "Where there have been war expansions far beyond any possible post-war future, it will be better to cancel war contracts earlier and begin reducing the 'bloat' than to wait until it has to be done all at once." The report also said: "Some short-sighted persons will oppose prompt decisions in the hope of continuing unnecessary production."

The division of opinion which Messrs. Baruch and Hancock foresaw is appearing. Some manufacturers want to discontinue production of every war article they make, the instant it is no longer needed. They do not want to be parties to the waste, the cost and the inflationary effect of making things or maintaining plants for which the country has no use, nor will have any use. Their view is that the true interest of themselves and everyone else will be served best by keeping down the expense of the war and the rise of the government debt. They recognize that the changeover has to come, and they want to start making it as soon as the situation permits, and get ahead with production of peacetime goods.

Some, on the other hand, are more inclined to shrink from the burdens that sudden contract cancellations will place upon them. They are inclined to temporize, to ask for long notice of cancellation or other delays, in the effort to provide a cushion against too sharp a turn from the war economy to the peace economy. They are apt to have support from the labor unions. Also on their side will be theorists who believe that production for its own sake and for the sake of employment, rather than for its economic value, is the desirable goal, and who argue that war production should be maintained past its need, regardless of cost, in order to make work and cushion the transition.

During the past few days workers of an airplane plant, whose contracts for fighter planes have been cancelled by the Navy as part of the program already referred to, have staged a "sit-in" demonstration to protest against the cancellation, which the union leader called a "blackout of post-war plans and a policy of confusion and chaos." Evidently the fact that the Navy no longer needs the planes, and that other factories, including many war plants, need the workers, is of little importance in the union's view. But it is plain that if the needless production were continued it would be a waste of materials and labor, weakening the war effort or the revival of civilian production—and all at the public expense, adding to the financial burden and the inflationary menace.

The argument that the Government should "make work," irrespective of the cost and economic value of the work, is one that had no standing in this country before the great depression. Its repetition now, to justify con-

tinuing unnecessary war production, is a holdover from the depression. Overlooking for the moment the question whether "making work" of no economic value was ever good practice, its continuation in a time of pressure on the productive organization and of fiscal hazard, such as the present, can hardly be supported. What is now wanted is constant scrutiny of the production program, in the light of accumulating stocks; prompt cutbacks where possible; reduction of costs and of the fiscal hazard; and the earliest practicable start on reconversion. For the time being at least, these changes will impose on most of the workers affected only one hardship—the inconvenience of changing a job.

The Place of Production Controls

The second question of major interest as reconversion approaches is the part that government controls, "guiding" or "planning" should play in the process, as against the alternative of trusting private initiative and competition to carry it out most effectively. One point on which all can agree is that civilian production quotas, limitations on the use of materials and similar restrictive regulations should go by the board when contract cancellations become as general as they seem likely to be at the end of the European war.

Some think it self-evident that restrictions should be abandoned, and feel little apprehension that they will be continued too long. But this view may be overly complacent. The danger is that enough people may think government controls wiser or more equitable to competitors than the operation of private enterprise. Also, making all exceptions for the many men devising and administering the controls who desire nothing so much as to have the day come when they can be wiped out, there are others wielding power who will like to retain it. Still others seek to supersede private enterprise by government direction and regimentation, and view "planned reconversion" as a step toward "planned economy." Public opinion probably will hold that price controls should be eliminated only gradually, and other controls may be lumped with price controls in the public mind.

As long as the war requires a major share of industrial output, restrictions on civilian production and use of materials will be accepted as necessary. Government direction and control is appropriate for a time of scarcity, when the demands on the industrial organization are greater than it can supply and it is necessary to see that war needs are satisfied first. But when the demand recedes the policies will no longer be appropriate. The problem will not be to restrict people from making what they want to make, but to remove every obstacle that will hamper them in producing everything for which they think they can find a market. If these obstacles are not removed as rapidly as the need for restriction diminishes they will create unnecessary depression and unemployment.

Nor is it sufficient to argue that the regulations and controls, if maintained, will not be operated in a restrictive manner. For they are restrictive in their nature. Their existence causes confusion and disturbance. Decisions as to what can be produced, and where and when, as facilities are released from war work, in last analysis will have to be made as always by millions of individual business men. To require them to apply to Washington for authority to produce, and to obtain the necessary materials and components, would place an intolerable burden both upon business and upon the Washington agencies. No surer road to delay in reconversion could be found.

Some think that reconversion guided by an overhead authority would be fairer and wiser than the decisions reached through the operation of free enterprise and competition. However, the pressures of conflicting interests, the delays, red tape, mistakes, vacillations and conflicting decisions by different agencies are well-known. They have been demonstrated in the electric iron program, which has been "off again" and "on again" with quotas fluctuating between zero and 2,000,000, and with innumerable conflicts to be resolved in the determination of quotas. This, to be sure, was one of the early programs for resumption of civilian production. Doubtless much will be learned from the experience. But the burden of proof clearly rests upon those who maintain that overhead direction of this kind will, under conditions of reasonably free supply, produce a fairer or wiser result than uncontrolled enterprise.

It will not be possible to remove controls from the distribution of materials and components, and from the civilian production using them, as long as reconversion can be only limited and piecemeal. But a principle is involved, which should be established at the beginning, namely that restrictions of this kind should come off at the earliest possible moment. Moreover, as the Baruch-Hancock report pointed out, no serious harm will be done if controls over the distribution of materials are taken off too early. For the trend will be in the direction of abundant supply, catching up with needs, whereas in going into war production the reverse was the case.

The Business Outlook

Business men are in the unusual position of knowing what the next major change in the business situation will be, i.e., curtailment of war production and release of plants, materials and labor for peacetime work. Nevertheless,

they face major uncertainties. They do not know how fast cutbacks in the war program are likely to come, and how far they are likely to go. They do not know to what extent manufacturers whose war contracts are cancelled will be permitted to resume civilian production, or what the governing policies will be. These questions are of concern not only to war producers but to the whole country, for upon the answers will depend the state of employment and trade. Over all is the uncertainty as to the invasion and its outcome, and the speed of the subsequent assault on Germany if the invasion is successful; and this is the factor which will control everything else.

With these uncertainties manufacturers have become more conservative in inventory policy. They are compelled to carry heavy inventories, particularly of goods in process, for war work, but the safe rule is to carry only what is allocated to specific war contracts or will be usable in peacetime operations. In some lines at least the hazard of price decline is to be considered. The slight downward trend of manufacturers' inventories during the past few months, as reported by the Department of Commerce and the National Industrial Conference Board, is evidence that the majority take a cautious view.

Merchants naturally want to form an opinion as to the prospects for industrial activity and employment in their trade area, and also want to know what to expect in the way of changes in production of civilian goods. They have been doing a huge business. As compared with sales their inventories are relatively small, but they are larger than many observers expected could be maintained and the danger of unbalanced stocks and excessive supplies of inferior or "ersatz" merchandise is a special wartime hazard of which all are aware. Their problem is to have inventories under control in case of either a decline in consumer purchasing power or replacement of the "ersatz" by standard goods. There is much evidence that stores are classifying their goods and reducing the risk to the minimum consistent with meeting the demand.

During this waiting period industrial production in the country has declined slightly, from a peak of 247 made last November, in terms of the Federal Reserve Board's index (1935-39 = 100), to 240 in April this year. Little significance, however, attaches to the drop, except as evidence that the industries have reached maximum output. The fall is accounted for by a tightening labor supply in some lines and by certain changeovers and cutbacks in war production, and of course it has not signified any lack of demand. When demand falls off and contract cancellations become widespread the fall naturally will be more rapid, depending in extent largely upon the way reconversion problems are dealt with both by industry and government.

Commodity Prices Stable

The general price trend has attracted little attention of late, inasmuch as the movement of the price indexes has been small. Wholesale commodity prices on May 20, according to the index of the Bureau of Labor Statistics, averaged exactly the same as a year ago. The official cost of living index in April was 124.5 (1935-39=100) Although this figure was up 0.6 per cent from March, partly because of the higher excise taxes which took effect April 1, it was still below the wartime peak of 125.1 reached in May of last year. Retail food prices are some 5 per cent lower than a year ago, but clothing prices are higher.

The present price level shows that the alarmist predictions of runaway advances that were being made a year or more ago were wide of the mark. These predictions were based chiefly on the increase in the supply of money, as a measure of demand, and on the "gap" between disposable money income and the estimated production of consumers' goods and services. Where they went wrong was in not giving enough weight to the price controls, to the restraint which buyers might exercise, or to the possibility of increasing supplies through greater production or releasing surpluses held by the armed forces. In fact, the controls have been effective; most people still exercise a considerable measure of economy and good sense in their financial affairs; and above all supplies have been greater than the pessimists predicted.

In some commodities normal supply and demand conditions are holding prices below the ceilings, and in a few the pressure of surpluses has forced prices even below the support levels which the Government is attempting to maintain. Wheat futures have dropped below the ceiling, on the bright crop prospect. Eggs are below the support price of 30 cents on the farm, for the Government has not had the buying organization in the primary markets, or the means of storing or disposing of the eggs bought, to make its support effective. Hogs outside the weight range of 180 to 270 lbs., which is supported, have sold $2 below the support price of $13.75. Lard is offered freely below the ceiling. Potatoes were selling below support prices until a freeze struck the Florida crop. The lesson is that when storage facilities become loaded to the limit, and "contingency reserves" accumulate beyond reason, while at the same time consumption is restricted by rationing or arbitrarily supported prices, something has to give way.

The government support prices were offered to producers some time ago, when the policy was to stimulate production. Where supplies have become excessive and discouragement of production is needed, the earlier commitment is now against the general interest. It is an obstacle in the way of increasing consumption and reducing output to levels which will balance the markets. It results in government accumulation of stocks, and a deplorable aspect of the accumulation is that spoilage has occurred in several important cases.

Dangers Still Present

To the extent that supply and demand, even in limited areas, are averting the danger of runaway prices, there is every reason for satisfaction. It would be a pity, however, if the current price stability should lead to a complacent attitude with respect to the inflationary threat. After some success in fighting inflation, people tend to tire of the subject and become dulled to the danger. They need to be reminded that the business losses, depression and unemployment which set in less than two years after the end of the first World War, when prices dropped 45 per cent and industrial production 33 per cent, were not so much the direct result of war as of the price inflation after the war. The troubles were directly due to the excesses of 1919 and 1920.

Today the heart of the postwar problem is to avoid a similar spending spree. The basic forces which produced the inflation of 1919 and 1920 are with us today but raised to a greater power. Government deficits are much larger and the increases in currency and bank credit have been far greater. Wage cases are pending which, if decided for the unions, would probably start a new cycle of wage increases in the industries. The rise of farm land prices—as great in percentage as during the corresponding period of the first World War—has evoked warnings from both public officials and farm authorities. The rise started from a severely depressed level, it leaves prices only 14 per cent above 1913 and one-third below the peak of 1920, and evidently no great alarm need be felt up to this time. But it is well to bear in mind that no one can predict with certainty where inflationary pressures will find an outlet.

Extension of the price control legislation for a year or eighteen months seems assured. The fate of the many amendments proposed to the Act is uncertain; opposition to subsidies on the scale now authorized, however, has been dropped. The case in favor of continuation of the price control authority has been unanswerable. Despite the instances where increased supplies are absorbing the price-raising pressures, no responsible group would care to be in the position of lifting the lid generally at this time.

The Fifth War Loan

With D day for the Fifth War Loan drive established as June 12, plans are nearing completion for the most intensive selling campaign yet attempted in financing the war. Throughout the country, the banks and investment houses, commerce and industry groups, and various other organizations are being mobilized under the leadership of the State War Finance Committees to carry the appeal for funds directly to every business, institution and individual that can possibly be reached.

In lifting the goal of the drive to $16 billions, the Treasury has placed before the American people a challenge that they cannot fail to meet. It is recognized, however, that the raising of such immense sums at intervals of only a few months becomes a progressively tougher job. As many of the more readily accessible sources of idle cash and savings become more fully invested, it becomes necessary to find additional sources of funds both by reaching new investors and by encouraging larger subscriptions from old investors, who can be induced to save more and to put their savings into war bonds.

There is always a danger, as one drive follows another, of people becoming a little "tired" and regarding them as an old story. There may also be a tendency towards complacency, engendered by the success of previous loans. This, though not unnatural, must not be allowed to develop. There is no slackening or complacency in the way the armed forces are going about their job, and there should be none on the part of the people at home who are having so much easier a time. It will be the task of the selling organization to awaken the people anew to the urgency of the situation, in which case their full support is assured.

Organization of the Drive

In the organization of the drive, increased emphasis is being placed in many communities upon the formation of commerce and industry committees to aid in the coverage of business concerns and personnel, a method that has been found successful in making more contacts and stimulating group competition in many community drives. At the same time the banks and investment houses are planning to intensify their efforts in the drive, contacting their own accounts, and cooperating with commerce and industry and other groups in the endeavor to see to it that everyone is personally asked to buy a bond.

As a standard by which the banks may judge their own sales results, the American Bankers Association has suggested a goal of sales for each bank amounting to 25 to 50 sales per employee and 14 per cent of its deposits—

the latter arrived at by dividing the sales to be cleared through the banks on the basis of the last drive by the amount of aggregate bank deposits, excluding interbank and government deposits. The part that the banks have played in furthering the success of the bond drives has been extremely important, and has been recognized by the Treasury in the statement that in the Fourth War Loan 80 per cent of all sales came in through the banks, a good part of which — it might be added — was due to the sales efforts of the banks themselves. While all banks have shared in the work of the drives, there has been considerable variation in the effort which individual banks have put forth, partly no doubt due to lack of adequate measures for comparison. The new sales quotas suggested by the Association may therefore be helpful in enabling banks to see how they are "stacking up" and thus encouraging each to make the best possible showing.

Again, as in the past drive, the effort is being made to reach genuine savings, and to keep down the volume of speculative subscriptions. Dealers and brokers have been officially requested to limit their subscriptions to the amount which they will be able to retail to customers other than commercial banks, in addition to their own investments. Purchasers of securities who borrow in order to buy will be expected to take up the securities within a reasonable period, and not to carry them on margin for resale at a profit.

The following table gives the results of the first four war loans, and indicates where progress is being made as well as where more work needs to be done.

Condensed Summary of Sales in the First Four War Loans
(In Millions of Dollars)

Investor Class	First War Loan	Second War Loan	Third War Loan	Fourth War Loan
Individuals				
E Bonds	$ 726	$ 1,473	$ 2,472	$ 3,187
Other Securities	867	1,817	2,905	2,122
Insurance Companies & Mutual Savings Banks	2,319	3,603	4,128	3,403
Dealers and Brokers	886	544	894	433
All Others (Mostly Corporations)	3,062	6,039	8,544	7,585
Total Non-banking Investors	7,860	13,476	18,943	16,730
Commercial banks	5,087	5,079	....	....
Grand Total	$12,947	$18,555	$18,943	$16,730

The results show a steady growth in the sales to individuals, especially in the case of Series E savings bonds which are taken largely by the smaller investors. Sales to insurance companies and mutual savings banks and to the wealthier individual investors, on the other hand, after increasing steadily in the first three drives, fell off in the fourth, reflecting the lessened availability of accumulated cash and funds derived from sale of other securities.

Sales to brokers and dealers were down sharply in the fourth loan as a result of the curbing of speculative subscriptions, while sales to "others," mostly corporations, likewise declined after having increased in earlier drives. Commercial banks, of course, have been excluded from the regular drives since the Second War Loan, save for the privilege accorded of limited investment of savings deposits in the fourth loan and now to be extended to the fifth.

In considering future drives, it becomes evident that the major sources of additional funds that must be looked to are the corporations and the great mass of individuals. With the expansion-of-capacity phase of the war production program now virtually completed, corporations by and large are no longer under the necessity of putting increasing amounts of funds into inventories and plant and equipment. As a consequence, increasing corporate cash holdings are becoming available for investment in government securities of the shorter term. This should become a more important source of funds in subsequent drives.

Need for More Individual Subscriptions

The other main source of funds, which so far has fallen far short of yielding its full potential of subscriptions to the bond drives, is the tremendous amount of cash in the hands of the public. While it is true that high taxes and rising living costs are squeezing the resources of a great many people, there is ample evidence that great numbers of other people have plenty of money to spend or are holding in safety deposit boxes, in mattresses, or other places of hiding, vast amounts in the aggregate of idle cash that ought to be invested in war bonds and working for the war effort.

Indications of this condition are found in the reports of widespread spending on non-essentials and luxuries, and in the huge amounts of currency outstanding, now almost $22 billion and still rising at the rate of $5 billion per year. There has been a growth of gambling and betting throughout the country, with bookmaking rife in many factories and communities and sums being bet on horse racing that are far in excess of those publicly reported. All this represents money that ought to be invested in war bonds, to contribute to the war effort, diminish inflationary pressure, and build up a backlog of income-producing savings to which individuals will be able to turn when the war jobs are over.

The Securities and Exchange Commission, in a report recently issued, warned that despite the fact that total "liquid savings of individuals" (cash, bank deposits, securities, insur-

ance and retirement of debt) last year reached the enormous sum of $37 billions, nevertheless anti-inflationary appeals were falling upon many deaf ears, else the total would have been considerably larger. The Commission continued:

The ratio of liquid saving to income after taxes has remained relatively constant since the middle of 1942, in contrast to the rapid increase in the proportion of income saved prior to that time. It is noteworthy that during this eighteen-month period individuals did not show any disposition to curtail the proportion of their income, after taxes, spent on goods and services in spite of patriotic appeals and the "normal" tendency on the part of individuals to save a larger proportion of their earnings as income increases. In the latter part of 1943, individuals for the first time since the beginning of the war actually decreased somewhat the proportion of their income which went into saving.

Moreover, an indeterminate amount of such "savings" does not represent genuine savings in the ordinary sense of the term, but merely accumulations of cash and idle bank deposits resulting from the shortage of goods on which they otherwise would have been spent. Such abnormal accumulations, where held in the form of currency, ought to be invested in war bonds directly or placed in institutional channels such as insurance companies and savings accounts in banks where they will in turn flow into government securities.

The Treasury in raising the quota for individuals in the Fifth War Loan from $5½ to $6 billions recognized the need for getting more subscriptions from this source, and the figure seems moderate in view of the huge amounts of cash in the hands of the public. If people can be brought to a full realization of the sacrifices being made on the battlefronts there will be no difficulty in reaching this higher loan goal. At the same time, people will turn in fewer bonds for redemption after the drives, choosing, wherever possible, to do without other things instead.

The Example of Canada

In this connection it is interesting to note that the Canadians have just finished up their Sixth Victory Loan and their eighth war loan, with results that apparently have surpassed all previous records. While full returns are not yet completed, the indications are that subscriptions numbered perhaps 3,200,000 and that the dollar total was in the neighborhood of $1.4 billion; and this in a country of about 11½ million population.

Subscriptions by individuals are expected to be close to $650 millions, or well in excess of the goal of $525 millions, and represent 46 per cent of total subscriptions from all sources. The following table from the annual report of the Bank of Canada for 1943 shows the progressive increase which has taken place in the total number of applications, and in the volume of war bonds sold to individuals of moderate means (as distinct from individuals of larger means in the Special Names Canvass).

Distribution of Canadian War Loans

	Total Number of Applications	Amount of Cash Applications by Individuals (ex Special Names)
1st War Loan—Jan. 1940......	178,000	$132 millions
2nd " " " —Sept. 1940......	151,000	113 "
1st Victory Loan—June 1941	968,000	280 "
2nd " " —Feb. 1942	1,681,000	336 "
3rd " " —Oct. 1942	2,032,000	375 "
4th " " —Apr. 1943	2,668,000	530 "
5th " " —Oct. 1943	3,033,000	604 "
6th* " " —Apr. 1944	3,200,000	650 "

*Preliminary.

Comparison of this showing with the results of the drives in this country is difficult to make for various reasons, including the fact that the Canadians concentrate a very high proportion of their general public bond selling in two major drives each year, whereas in the United States relatively larger sums are being raised apart from the drives by regular purchases under the payroll deduction plan. In our Fourth War Loan it was stated that the total number of sales was around 50 millions, but this was a rough estimate whereas the Canadian figures are actually reported number of sales. It will be noted that the $5.3 billions of bonds sold to individuals in our Fourth War Loan drive amounted to less than a third of all non-banking subscriptions, compared with the ratio of 46 per cent for the Canadian Sixth Victory Loan, as reported above.

One further measure of the results in the two countries is to compare the total sales to individuals in the two 1943 Victory Loans for Canada, as given in the table, amounting to $1,134 millions, with the S.E.C. estimate of net absorption by individuals in the United States of government bonds in 1943, amounting to approximately $14 billions. In the case of Canada, the figure was about 13 per cent of the national income estimated at around $8.8 billions, as against 10 per cent of the national income for the United States estimated at $143 billions. While the Canadian sales figures are gross and those for the United States are net after resales and redemptions (in the case of war savings bonds), on the other hand the Canadian figures exclude subscriptions by individuals of larger means, also savings certificates, while the United States figures do not.

This much is sure, that in the success of the Sixth War Loan in surpassing all previous sales records the Canadians have set an example which we may well emulate in our Fifth War Loan.

Smaller U. S. Bond Purchases by Banks

A significant feature of the bond situation on the eve of the new war loan is that thus far the pre-drive selling of securities in connection with portfolio rearrangement by insurance companies and other large non-commercial bank investors has been markedly lighter than before previous drives. Since securities coming on the market in this way have to be absorbed by the banking system, the lessened supply of offerings from these sources has naturally affected the rate of expansion of bank credit.

Over the period from the close of December to May 24 which included the Fourth War Loan drive, the holdings of government securities by the weekly reporting member banks increased but $1.1 billion, indicating a total absorption for all commercial banks of something less than $2 billions. At the same time, holdings of government securities by the Federal Reserve Banks increased by approximately $2.4 billions, making the combined commercial bank-Federal Reserve increase for the five months under $4.5 billions. This represents an annual rate far below last year's final takings by the banking system of $23,826 millions, and those the year before of $23,520 millions.

No doubt the reduction in the rate at which bank purchases of government securities are running this year is due in part merely to time lag. The currency increase, which is the main factor in the growth of securities held by the Reserve Banks, is usually greater in the second half of the year than in the first. Also, heavier selling of securities by non-banking investors is to be expected during the bond drive, and will have to be absorbed by the banks. One favorable symptom in this regard, however, is the thorough liquidation that has taken place in loans contracted to carry government securities during the past drive. At the middle of May reporting member bank loans to brokers and dealers on governments were well below the level at the start of the Fourth War Loan. Their loans to "others" on governments were back to approximately the same level as before the past drive.

While the rate of bank absorption of governments will probably increase, there are nevertheless good reasons for thinking that the total this year may fall considerably below the roughly $24 billions and $23½ billions for 1943 and 1942, mentioned above. One reason is the substantial improvement that has taken place in the federal budget position, due to the marked increase in tax receipts and levelling off in expenditures. In the period January 1 to May 29 the cumulative deficit of $21.8 billions was approximately $2.8 billions less than in the corresponding period a year ago, indicating a much larger decline for the full calendar year, especially if war expenditures should decline from their present level. And, of course, less deficit means less new debt to be financed.

A second reason why bank absorption of governments may be less this year than last has to do with the timing of the bond drives. If, as has been suggested, there should be a sixth war loan towards the close of this year, it would mean three loan drives this year instead of only two as in 1943. Naturally, this would mean a larger absorption of securities by non-banking investors.

This is an indication of real progress in the fight against inflation, because increases in bank purchases of securities mean increases in deposits and buying power. This is the objective to which our efforts in the Fifth War Loan are directed. We want to make sure that our fighting men, when they come home from abroad, will find a stable economy in which to seek jobs and make a living.

The Growth of Sterling Balances

In our April Letter we discussed the large accumulation of purchasing power in the form of gold and foreign exchange reserves that has taken place since 1940 in the countries of Central and South America. In the countries included in the present "sterling area" an even more rapid accumulation of sterling balances by others than the United Kingdom has occurred. This group includes the countries of the British Commonwealth (with the exception of Canada and Newfoundland), British Mandated Territories, the Belgian Congo, Egypt, Iraq and Iceland. While all but about one-seventh of the exchange resources accumulated at the end of 1943 by Latin American republics were either gold or dollar assets, the sterling area funds in the main are balances on deposit in London or invested in British Treasury bills, and hence subject to the British exchange control.

Under the conditions of the exchange control, the accumulated funds are freely usable within the sterling area. Their transfer to other currencies is restricted, however, to "essential" foreign exchange requirements and hence they are often referred to as "blocked". Great Britain is under obligation to provide for the essential foreign exchange needs of sterling area countries from the common central pool into which flows the foreign exchange earned by these countries in the course of international transactions. That the accumulated London balances are not being used up at a greater rate, has been due to an understanding between the member countries that they will keep generally in step on import restrictions and exchange control so as to prevent London from being called upon to furnish foreign exchange for non-essential uses.

The cause of the accumulation of sterling balances, like that of the growth of Latin American gold and dollar assets, has been fundamentally the tremendous disparity in the balance of payments caused by the war. Not only have sterling area merchandise exports to Great Britain greatly increased, but in some cases these countries have provided the British Army with local currencies to pay troops and local help for which they have received sterling credit in London. At the same time their imports from Great Britain have been curtailed, due partly to shortages of goods and partly to import restrictions self-imposed in the interest of the common war effort. Thus their funds have piled up in London.

During the early stages of the war, repatriation of sterling area marketable securities held in London absorbed a considerable part of these funds. But as the supply of securities was depleted, balances piled up more rapidly. In 1942, as far as can be estimated from incomplete data available, the balances in London increased about £400 millions. In 1943, the rise was about £500 millions, and this rate may be exceeded this year because of expenditures in connection with the Burma campaign, continued purchases from South America and neutral countries, and chartering of ships from European Allies.

Another factor in the growth of London balances has been the accumulation of surpluses in the balance of payments between some of the sterling area countries, such as India and Australia, and the United States. These surpluses have originated in part from our purchases of their goods, but more recently to a much greater extent from expenditures of our armed forces. The dollars for the most part have been paid into a common pool in London where they are available to all sterling area countries for their essential requirements. At the end of February, however, it was announced in the Indian budget that the British Government had agreed to set aside part of the dollars accruing to India from United States purchases and expenditures for Indian postwar development.

Britain's Adverse Balance of Payments

The extent of Britain's adverse balance of payments, not covered by the lend-lease arrangements with the United States or the contributions by Canada, was estimated in the Third White Paper, published in connection with the 1943-'44 budget. Using this and other available information, Dr. Nicholas Kaldor of Cambridge University made a rough calculation as to how the adverse balance of payments incurred from the beginning of the war up to the end of 1942 was met. His estimate, published in the June-September, 1943, issue of the Economic Journal, is given below.

Britain's Adverse Balance of Payments, 1939-1942
(All Figures in Millions)

	Pounds Sterling	Dollar Equivalent
Loss of gold and foreign exchange....	650	2,600
Sales of securities....	875	3,500
Accumulation of sterling balances and free loans	825	3,300
	2,350	9,400

In 1943, according to the Chancellor of the Exchequer's latest budget message, the adverse balance in international payments was £655 millions. Thus the total wartime adverse balance of Great Britain up to the end of 1943 aggregated about £3,000 millions over and above the lend-lease aid received from this country and Canada's mutual-aid appropriation of 1943-44.*

Of this amount somewhat more than one-half probably was covered by drawing on Britain's overseas capital and exchange resources, including the loss of some £650 millions of gold and foreign exchange (largely to the U.S. before lend-lease) and the liquidation of about £1,000 millions of overseas investments. This would leave a balance of about £1,300 millions borrowed at short-term from the sterling area and a few other countries which regularly supplied the British market before the war. In comparison it may be noted that during the first World War, Britain liquidated about £900 millions of her foreign investments, largely U. S. railroad stocks and bonds, and contracted a war debt of about £1,250 millions to this country.

Britain's Short-Term Debt Over £1.5 Billions

The growth of Britain's short-term indebtedness to individual countries is brought out in the table on the next page. It seems, on the basis of published data, unfortunately far from complete, that at the end of 1943 London was a debtor on short-term account to the extent of at least £1,500 millions, equivalent to about $6 billions. Though the figures given for individual countries may not be precise, it will be noted that between 1939 and the end of 1942 the table shows roughly about the same aggregate accumulation of short-term balances as estimated by Dr. Kaldor.

* Britain's shortage of Canadian dollars amounted to about $1,800 millions (Canadian) up to March 1942, and was covered by shipping gold ($250 millions), the repatriation of government debt and private securities ($840 millions) and the funding of the balance (about $700 millions) into an interest-free loan for the duration. In the year ended March, 1943, the Canadian Government contributed $1 billion to finance British purchases, and in the following year another billion to finance aid to the United Nations.

London Balances of Sterling Area and Latin America
(In Millions of Pounds Sterling)

	Dec. 1939	Dec. 1941	Dec. 1942	Dec. 1943
Sterling Area				
India: Reserve Bank	£86	£207	£358	£644
Canada: Interest-free loan	(a)	44	159	159
Eire: Currency Com. and Irish Banks	75	100	125	147(b)
Malaya	(a)	60	60	60
Australia: Com'wealth Bk.	35	48	63	82
New Zealand: Reserve and Trading Banks	18	20	38	35
South Africa: Reserve Bk.	8	—	1	13
Palestine: Currency Bd., and Trading Bks.	5(d)	10(d)	23(d)	67
West Africa: Currency Bd.	12(c)	15(c)	17(c)	23(c)
East Africa: Currency Bd.	8(c)	4(c)	9(c)	16(c)
Egypt: National Bank	22	53	83	106
Iraq: Currency Board	6	12	22	32(b)
Total Sterling Area	265	573	953	1,384
Other Countries				
Argentina: Central Bank	(a)	(a)	19	54
Brazil: Banco do Brasil	(a)	(a)	(a)	30(e)
Uruguay	(a)	(a)	(a)	4
Grand Total	265	573	972	1,472
Dollar Equivalent	1,060	2,292	3,888	5,888

(a) Not available. (b) September 1943. (c) As of the middle of the year. (d) March 1940, 1942 and 1943 respectively. (e) Estimated.

NOTE: In the absence of complete data, the liquidation of British overseas investments may be estimated as follows: India, £350 millions; South Africa, £155 millions; United States, £145 millions (as reported up to the end of 1941); Canada, £185 millions; Egypt, £14 millions; Argentina, £23 millions, and Australia and New Zealand, about £10 millions; total of above, £878 millions. In addition securities and direct investments worth about £125 millions, as well as earnings of branches of British insurance companies in this country, valued at about £50 millions were pledged in July 1941 against Reconstruction Finance Corporation loans in the United States.

This total is understated. It does not include, for example, balances of the Belgian Congo and Iceland — both sterling area countries — nor those of the Dutch and French possessions included in the sterling areas until this Spring. Nor does it include the sterling balances of many non-sterling area countries, such as Canada, Sweden, Turkey, Portugal, or sterling earnings and compensation for shipping losses of the Norwegian, Greek and Dutch merchant marines. The Bank of Portugal alone holds foreign exchange equivalent to some $500 millions, some of which undoubtedly is in sterling.

In considering these figures, it should not be thought that sterling balances of non-sterling countries are "blocked" in the sense of being wholly inconvertible into other currencies. The British Government has entered into special arrangements with various non-sterling area countries whereby considerable latitude of withdrawal is permitted. In come cases residents of such countries are allowed free conversion of their normal sterling balances on demand at the usual rate, while in others the conditions are more complicated and restricted.

As to the gold and dollar assets of the sterling area countries, the published figures credit them with about $1,000 millions of gold at the end of 1943. By far the largest holder of these disclosed gold holdings was the Union of South Africa with about $700 millions to its credit. The $275 millions held by the Indian Reserve Bank was a part of the currency backing.

In addition, London has acquired some amount of gold and dollar assets in exchange for sterling from the sterling area countries and from the expenditures of American troops in Great Britain.

Repatriation of Sterling Area Debts

The largest short-term sterling debt was owed by Britain to India. In 1943 it was increased by almost £300 millions and was around £700 millions at the end of March, 1944. With the repatriation of £350 millions of Indian Government sterling obligations, the possibility of further repatriation of Indian public debt has been practically exhausted. Thus there is no longer any check on the accumulation of sterling funds except perhaps repatriation of British investments in private-owned Indian enterprises.

In the meantime British expenditures on Indian defense and payments to the Indian troops outside of India continue at a high level. India's export surplus is running at the rate of about £75 millions a year. While a substantial portion of the export surplus is with the United States, the proceeds together with large expenditures of our armed forces have been credited to India in sterling. Reference has been made above to the recently inaugurated policy of setting aside part of the dollars accruing from U. S. expenditures and purchases in India for Indian postwar uses.

Even if no further accumulation of sterling were to take place, India will emerge from the war in a creditor position. A similar shift is taking place in South Africa which has been selling gold in London to pay for the repatriation of her overseas Government debt of about £100 millions. In addition, the country has repurchased more than £50 millions worth of gold shares since 1939, according to a London Economist estimate

Last September Egypt decided to convert its sterling debt into internal loans, and in the course of this operation presumably £14 million of this debt held in London has been repaid.

Reduction of Long-Term Investments

In addition to increasing this huge short-term debt, Great Britain during the war has liquidated some £1,000 millions of her overseas long-term investments. Because of these changes, the Chancellor of the Exchequer in presenting the current budget on April 25 warned that Great Britain will emerge from this war, for the first time in modern history, no longer a creditor nation.

Great Britain's long-term investments were estimated by Lord Kindersley at the nominal value of about £3,725 millions in 1938, exclu-

sive of investments in Eire. The reduction of £1,000 millions in her holdings represented a greater proportion of her actual income-producing investments than the figures indicate. Moreover, the income from the £250 millions of investments in the occupied countries of Europe and the £400 millions in Southeastern Asia has been lost, at least temporarily. Of the remaining investments, those of Latin American government and railway securities in particular (over £650 millions) have yielded little return. In the last prewar years, 1936-38, the income from investments averaged about £200 millions, but British sources estimate that in the postwar period this may be reduced to about £125 millions.

The reduction of the income from investments is only a part of the story of the change in Britain's international position. With the enlarged merchant marine of this country, of Canada, and some other countries, many doubt that Britain's shipping earnings can recover to the prewar levels. This may also be true of commissions earned by brokers, banks, and insurance companies, whose business may be diminished if exchange and trade controls are maintained.

As the Committee on Post-War Problems of the Conservative Party estimated in a report published last January, there is likely to be an adverse balance of payments of at least £200 millions a year in the immediate postwar period, which must be made up by a greater volume of exports of merchandise and services.

Postwar Implications

The accumulation by Great Britain of a huge short-term debt, which on the basis of the table, may aggregate close to £2 billions ($8 billions) by the end of this year, poses one of the great problems of the postwar period. If the abnormal sterling balances built up in London are to be liquidated and the purchasing power which they represent released, it will have to be done, in the long run, through an expansion of British exports and services to the rest of the world. Great Britain must achieve a surplus in her postwar international payments, despite heavy shrinkage in income from foreign investments and possible reductions in other credit items in her international accounts as mentioned above. It has been estimated by some British authorities that Great Britain will have to increase her exports in the postwar period by a least 50 per cent compared with prewar.

It is concern over the magnitude of this problem that has led to discussion in Great Britain of the possibility of more extended use of Empire trade preferences, bilateral agreements, cartelization of industry, greater participation by government in foreign trade, and other devices and policies to stimulate exports and enable the country to pay for the imports of food and raw materials essential to maintain the people and provide employment. It explains also why other sections of British opinion which still adhere to the traditional British philosophy of liberal trade policies are so much interested in monetary stabilization plans regarded as holding forth hope of greater international cooperation in expanding trade and as providing assurance of some degree of financial support in bridging over periods of international adjustment.

Not all of the vast accumulation of sterling balances is, however, likely to be a problem. The main task will be in the settling of India's sterling claims amounting to almost one-half the total. But India as well as other countries both within and without the Empire will be wanting to maintain substantial balances in London for clearing and other purposes, especially if postwar developments are such as to create confidence in sterling. After all, London was one of the great international money markets before the war — for many years the greatest — and there seems no doubt but that she will continue to be a great international money market in the future. Sterling balances in excess of what countries will want to carry will be drawn upon as a more normal flow of goods is restored. The tremendous shortage of goods that has grown up during the war and that is reflected in the unexpended sterling and dollar balances as well as accumulations of gold will unquestionably create a huge demand for goods of all types, particularly in the first postwar years, that seems certain to tax the export capacity of both the United States and the United Kingdom to the full.

A difficulty of course in the British situation will be in meeting the extra strain upon the balance of payments in the interval of industrial reconversion and restocking of raw materials and footstuffs before a satisfactory outflow of exports can be established. It is expected that Great Britain will have to retain some form of exchange control and rationing of imports, at least during the transition period; and there may be need for other measures such as the funding of a portion of the sterling balances into long-term obligations, perhaps with the aid of loans extended from this country.

The solution of these problems cannot be regarded as matters solely of British or even British Empire concern. The United States and all other countries are interested in seeing reestablished a healthy flow of trade both into and out of Britain, and in freeing the large volume of purchasing power now held in sterling to seek goods in the most advantageous markets, wherever they may be.

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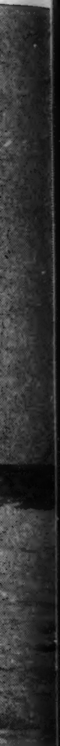

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